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No. 80-2092

IN THE

Supreme Court of the United States

OCTOBER TERM, 1981

SCM CORPORATION,

Petitioner,

v.

XEROX CORPORATION,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

PETITIONER'S SUPPLEMENTAL BRIEF IN RESPONSE TO BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

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The Government does not deny that the questions presented in this case are important and recurring questions of law. Nor does the Government support Xerox's argument that the decision below turns on the "unique" facts of this case. (Br. Opp. 13). The Government's position is that the court of appeals announced a rule under which *no* acquisition "by a company having no power in the relevant market at the time of the acquisition" can ever violate the antitrust laws (Gov. Br. 9)—a rule of unquestionable importance.[1] If the Government's reading of the decision below is correct, the court of appeals created a sweeping new rule of per se legality that conflicts

[1] The Brief for the United States is referred to as "Gov. Br."; other citations are in the form set forth in Petition 1 n.1.

directly with applicable decisions of this Court. The Government's brief underscores what SCM said in its Petition: the decision in this case will have a broad impact on antitrust law for years to come.

1. The Petition's premise is that the court of appeals erred in holding that acquisitions of patents prior to the emergence of a relevant market are exempt from antitrust scrutiny. The Government concedes that the Petition gives a "correct statement of the general legal principle" (Gov. Br. 9 n.8) governing implied exemptions, but contends that that principle is "irrelevant to this case" (*id.*) because it was "Xerox's lack of power in any relevant market at the time of the acquisition—and not the fact that the acquired assets were patent rights—[that] was the critical factor in the court of appeals' determination that the acquisition was legal." (*Id.* at 9).

SCM continues to believe that this is an exemption case. The court of appeals so understood its decision,[2] and Xerox has defended the decision on this basis. (Br. Opp. 16-18). As discussed in the Petition, the court of appeals failed to apply the controlling decisions of this Court on implied exemptions. (Petition 13-22). The Government does not contend otherwise. But it is unnecessary here to add to the discussion of this subject in the Petition, because the case, as the Government has recast it, presents issues of even greater importance and applicability than those discussed in the Petition.[3]

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[2] See, e.g., PA 30a ("the policies of the patent laws preclude the imposition of antitrust liability"); PA 36a ("[w]hatever the meaning that may be ascribed to § 7 in other contexts, the patent laws circumscribe the scope of the provision here"); see also, e.g., PA 17a, 32a, 35a.

[3] Under either reading of the opinion, the court of appeals' decision would have allowed the creation of impregnable monopolies in the numerous industries where alternative technologies were available prior to the time the relevant market emerged, including, for example, radio, television, photo typesetting and lasers. *See* J. Jewkes, D. Sawers & R. Stillerman, *The Sources of Invention* 286-89, 307-09, 332-34, 345-47 (2d ed. 1969); *A Laser Patent that Upsets the Industry,* Business Week 122 (Oct. 24, 1977). The court of appeals' decision will affirmatively encourage acquisitions suppressing such alternative technologies in the important new industries of the future, such as genetic engineering, microprocessors and electronics, to name but a few examples.

If the Government's reading of the decision below is correct, it is per se legal for a party without present market power to acquire any asset, even if there is a market in existence and even if the acquisition is certain to result in a monopoly.[4] The principle the Government finds in the court of appeals' opinion is one of great scope. It could, for example, abolish the potential competition doctrine entirely (see pp. 4-5, *infra*), for in all potential competition cases at least one of the firms involved lacks market power at the time the acquisition is made.[5] Thus, whether the Court accepts SCM's reading of the decision or the Government's, the case merits plenary review.

2. The Government's argument that the court of appeals' decision was correct is based on purely theoretical assumptions that are contradicted by the facts of record in this case. Application of that theory forecloses Rule of Reason scrutiny and represents a significant departure from the applicable decisions of this Court.

a. The Government's broad rule of per se legality—that "an asset acquisition by a company having no power in the relevant market at the time of the acquisition" can never violate the antitrust laws (Gov. Br. 9; see *id.* at 10-12)—is premised on the purely theoretical assertion that "no output restriction, and therefore no anticompetitive effect, can result from the transfer of an asset when at the time of the transfer neither party has any market power." (*Id.* at 11; see *id.* at 13 (anticompetitive effect "impossible")). This is certainly not the case in which to formulate such a per se rule. As this Court has held repeatedly, "[i]t is only after considerable experience" with a practice that a per se rule may be framed. *E.g.*, *Broadcast Music, Inc.* v. *Columbia Broadcasting System*, 441 U.S. 1, 9-10 (1979); *United States* v. *Topco Associates*, 405 U.S. 596, 607-08 (1972); *White Motor Co.* v. *United States*,

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[4] The Government acknowledges that the court of appeals erred in focusing on the lack of a "relevant market" in 1956, and that the court's decision "may cause confusion in subsequent cases." (Gov. Br. 10 n.9).

[5] The Government's rule also appears to make all vertical mergers lawful per se.

372 U.S. 253, 263 (1963).[6] Yet the Government endorses this per se rule, not only in the absence of "considerable experience," but in a case where the record and jury findings demonstrate that the premise for the rule is incorrect. This case demonstrates just how the ultimate anticompetitive effect—the creation of a persistent, substantial economic monopoly—can result from an acquisition made at a time when the parties lack present market power.

b. The Government cites no case holding that the defendant's lack of market power at the time of the acquisition is dispositive, and there is no such case. The cases the Government cites stand only for the correct proposition that the legality of an acquisition "depends *in part* on the market power of the defendant." (Gov. Br. 10 & n.9 (emphasis added)). None of the cases supports the broad rule of per se legality the Government contends the court of appeals adopted here.[7]

This Court's potential competition decisions are directly contrary to the Government's position. In *United States* v. *Penn-Olin Chemical Co.*, 378 U.S. 158, 173-76 (1964), for example, the Court held that the creation of a joint venture can violate Section 7 of the Clayton Act even if *neither* party has any market power prior to the time the joint venture is formed. And the Court has frequently held that the acquiring firm's lack of power in the market prior to the acquisition is not

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[6] As these decisions hold, in the absence of such "considerable experience," a court should apply the Rule of Reason to the practice and assess its impact on competition after a trial. SCM's position is that the Rule of Reason is applicable here. (Petition 16-18). The Government's response to SCM's Rule of Reason argument mischaracterizes it. The Government contends, for example, that SCM is urging a "least restrictive alternative" test and that such a test is inappropriate. (Gov. Br. 13-14 & n.14). In fact, SCM contends (Petition 17-18) that the applicable standard is the "reasonably necessary" test—the *same* test that was held appropriate in each of the cases cited by the Government. *E.g.*, *American Motor Inns, Inc.* v. *Holiday Inns, Inc.*, 521 F.2d 1230, 1249 (3d Cir. 1975); *Newberry* v. *Washington Post Co.*, 438 F. Supp. 470, 475 (D.D.C. 1977).

[7] The Government's view is also contrary to the Department of Justice *Antitrust Guide Concerning Research Joint Ventures* (1980), in which present market power is regarded as only one of several factors, and to the business review letters from the Antitrust Division to the Salk Institute for Biological Studies in 1975. (See Petition 18 n.19).

determinative. *United States* v. *Phillips Petroleum Co.*, 367 F. Supp. 1226 (C.D. Cal. 1973), *aff'd*, 418 U.S. 906 (1974); *United States* v. *Marine Bancorporation*, 418 U.S. 602, 623-26 (1974); *United States* v. *Falstaff Brewing Corp.*, 410 U.S. 526 (1973); *FTC* v. *Procter & Gamble Co.*, 386 U.S. 568 (1967). Accordingly, if the Government is correct in its view that Xerox's lack of market power in 1956 was dispositive in the opinion below (Gov. Br. 9), the court of appeals' opinion is in direct conflict with applicable decisions of this Court and should therefore be given plenary review.

c. As this Court's decisions have made clear, the key to decision is not whether an agreement is entered into at a time when the parties lack market power; the key is the effect of the agreement on existing and future competition. *E.g.*, *National Society of Professional Engineers* v. *United States*, 435 U.S. 679, 688-89 (1978). In many cases, an acquisition by a party lacking present market power will be harmless. In some cases, however, as the Government concedes, the acquisition can be quite harmful.[8] And in this case, the harm—the elimination of

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[8] The Government correctly states that it would violate both the Sherman and Clayton Acts if a firm owning a "superior" technology were to acquire the "second best" technology from another firm because such an acquisition would enable the acquiring firm to suppress the second-best technology and thereby capture "the difference between the 'superior' technology and the 'third best' technology" (Gov. Br. 10-11 n.10). That analysis is inconsistent with the Government's assertion that the defendant's lack of market power at the time of the acquisition ends the case. If the acquiring firm's "superior" technology has not been marketed at the time of the acquisition, the acquiring firm's lack of present market power will, under the Government's rule, render the acquisition of a "second best" technology lawful per se.

The Government is wrong when it asserts that "this is not a case involving suppression of rival technologies through acquisition." (*Id.*). A telling example is found in Xerox's suppression of alternative materials for the photoconductor, the heart of the xerographic process. All Xerox copiers used a selenium photoconductor, itself a Battelle invention which Xerox acquired. Xerox also acquired from Battelle a patent covering the use of zinc oxide as a photoconductor, an invention resulting from government-funded research. Xerox refused to license this patent for plain paper copying, and when Litton introduced a plain paper copier with a zinc oxide photoconductor in 1971, Xerox sued Litton for patent infringement. (SCM's brief below, at 36 n.10). Xerox also suppressed the TESI and xeroprinting alternatives to xerography which it acquired from Battelle and the liquid development technology it acquired from Horizons. (Petition 6; A 823, 2772-73, 2799-801).

substantial potential competition—is a matter of fact found by the jury. (PA 114a, 123a). Although the Government contends that it is "impossible" for such an acquisition to have an anticompetitive effect, its only response to the jury's findings misstates the record and substitutes *a priori* theory for record facts to the contrary.

i. The Government's contention that SCM failed to prove the elements of a potential competition case (Gov. Br. 12 n.11) is plainly wrong. SCM did "define the area of competition" (*id.*)—the convenience office copying market and plain paper copying submarket. SCM did "identify the potential competitors" (*id.*); they were not "some unnamed 'others' " (*id.*) but 20 specifically identified firms, including IBM, Kodak, 3M and Savin (SA 317-479). The reasons why those competitors "[we]re (or [we]re perceived as) likely entrants" (Gov. Br. 12 n.11), as well as their prospective performance in the market, were given not only by SCM's expert witnesses, but by Xerox's as well (A 4113-22; E 3064). SCM also showed how "independent entry would have improved competition in the market" (Gov. Br. 12 n.11) by demonstrating, *inter alia,* the increased output, lower prices and greater innovation that would have resulted from competition among those named competitors—competition the 1956 Agreement prevented. (Petition 5-7).[9]

ii. The Government asserts that "[t]here is no reason to believe that if Battelle had retained the patents it would not have granted an exclusive license to Xerox rather than granting multiple licenses." (Gov. Br. 12 n.11). The Government's *a priori* theory that sublicensing would not have occurred is directly contrary to the jury's specific finding that sublicensing would have occurred. (PA 123a). That finding was clearly supported by the evidence (see SCM's Reply Brief below, at 45-53) and withstood Xerox's challenges in both the district court and the court of appeals.

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[9] That independent entry would have improved competition is confirmed by what actually occurred in the market following entry of the FTC decree under which Xerox was required to license its patents. *Xerox Corp.,* 86 F.T.C. 364 (1975).

3. In an argument inconsistent with its earlier statements that the decision below did not "creat[e] a special rule for patents" (Gov. Br. 9), the Government contends that the patent laws preclude any distinction for antitrust purposes between the rights held by a patentee and the rights that a purchasing firm may acquire. (*Id.* at 8, 14, 16). The Government is incorrect.

As the Government and the court of appeals have conceded, patent acquisitions are not immune from the antitrust laws. (*Id.* at 9; PA 22a). Therefore, the fact that the patent laws permit patents to be assigned and provide that an assignee's rights are the same as the patentee's, 35 U.S.C. §§ 154, 261, 271, does not preclude application of the antitrust laws to invalidate patent acquisitions that affect competition adversely. *See, e.g.*, Baxter, *Legal Restrictions on Exploitation of the Patent Monopoly: An Economic Analysis*, 76 YALE L.J. 267, 349-52 (1966).[10] The law has been clear for more than 75 years that the mere fact that conduct is *authorized* by a statute does not preclude application of the antitrust laws when the effect of the conduct is to restrain competition. *Northern Securities Co.* v. *United States*, 193 U.S. 197, 345-51 (1904); *see also United States* v. *United States Gypsum Co.*, 333 U.S. 364, 400-01 (1948). In analogous contexts, this Court has held that the antitrust laws may be applied to strike down mergers approved by the Comptroller of the Currency pursuant to the Bank Merger Act, *United States* v. *Philadelphia National Bank*, 374 U.S. 321, 350-55 (1963), and mergers approved by the Federal Power Commission under the Natural Gas Act, *California* v. *FPC*, 369 U.S. 482 (1962); *United States* v. *El Paso Natural Gas Co.*, 376 U.S. 651 (1964).

4. As demonstrated in the Petition, the court of appeals' holding that the legality of an acquisition of patents can only

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[10] "Statutory authorization [for patent assignments] was necessary 'because since patent rights are creatures of statute and not of common law, the transfer of legal title thereto cannot be regulated by the rules of the latter system.'" 76 YALE L.J. at 349 (quoting A. Walker, *Patents* § 274 (1st ed. 1883)). Accordingly, the statutory authorization to assign a patent confers no "general imprimatur of legality. . . ." 76 YALE L.J. at 349.

be determined at the time of the acquisition—not at the time the anticompetitive effects of the acquisition have occurred—is in conflict with applicable decisions of this Court, including *United States* v. *E.I. duPont de Nemours & Co.*, 353 U.S. 586 (1957). (Petition 22-25). The Government has no answer to the argument that the court of appeals' decision allows monopolies of indefinite duration to be established and maintained; it just asserts that the court of appeals was right and that *duPont* is inapplicable to patent acquisitions.[11]

The Government argues that in *duPont*, but not here, the acquisition was found illegal because of post-acquisition conduct "evidenc[ing] the anticompetitive potential of the acquisition" (Gov. Br. 17 n.18). But that is precisely the case here. The 1956 Agreement violated the antitrust laws because its anticompetitive effects were manifested by Xerox's subsequent acquisition of monopoly power and its willful maintenance of that power by its repeated unreasonable refusals to license.[12]

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[11] In a brief filed in December 1979, however, the Government took the position that the *duPont* rule does apply:

> "Without case support or reasoning, SGK [the defendant] also asserts (SGK Br. 31-32) that the exclusive license was irreproachable under the Sherman Act because it commenced when a market for ATAs [the relevant market] was lacking. There is no requirement, however, that an evaluation of the net competitive effects of an agreement be confined to the moment when it was concluded. Indeed, an agreement which initially had a net procompetitive effect may become illegal if the nature of the market or industry has changed so that the original justification no longer fully pertains. For this reason, competitive effects are to be assessed at the time suit is brought. See *United States* v. *duPont*, 353 U.S. at 597; *United States* v. *Jerrold Electronics Corp.*, 187 F. Supp. 545 (E.D. Pa. 1960), *aff'd per curiam*, 365 U.S. 567 (1961)."

Brief for the United States at 34, *United States* v. *Studiengesellschaft Kohle*, 1981-2 Trade Cas. ¶ 64,394 (D.C. Cir. December 11, 1981). Although the court of appeals in that case ruled in favor of the defendant, it did not do so on the basis that the lack of a market (or market power) at the time of the license precluded liability; rather, the court held that the Rule of Reason applied and found the license reasonable under the traditional "reasonably necessary" test.

[12] The Government also asserts that "no case has premised antitrust liability on a single party's refusal to share the assets of a lawfully acquired

The Government's assertion that Xerox's monopoly did not result from the acquisition, but from "[s]ubstantial internal development" (Gov. Br. 17-18) is directly contradicted by the jury's findings. Xerox argued to the jury that its monopoly was based on internal development, and the jury was explicitly instructed that a monopoly achieved by one's own superior skill is entirely lawful. (A 4469-71; SA 831). But the jury found that Xerox's monopoly was the result of the acquisitions, not internal development. (PA 113a, 114a-15a, 118a-19a, 121a-23a).

* * *

The questions presented by this case are of unusual importance, as the Government's brief demonstrates. As SCM and Xerox read the court of appeals' decision, the court created, on the basis of "patent policy," an important implied exemption from the antitrust laws. As the Government reads the decision, an even more sweeping rule of per se legality was announced—a rule in conflict with every potential competition case this Court has decided. Under either reading of the opinion, the decision below permits—indeed encourages—the creation of long term monopolies in new technologies and products. The questions presented by the decision are ones of the first magnitude, and the petition for certiorari should therefore be granted.

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monopoly." (Gov. Br. 13 n.13). The Government is not correct. *See Hecht* v. *Pro-Football, Inc.*, 570 F.2d 982, 992-93 & n.44 (D.C. Cir. 1977), *cert. denied*, 436 U.S. 956 (1978); *see also Lorain Journal Co.* v. *United States*, 342 U.S. 143 (1951).

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